

Message Text

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ACTION SS-14

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E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: SITUATION REPORT, DECEMBER 17

REF: (A) STATE 267168; (B) LONDON 20315

1. THE CHANCELLOR'S MINI-BUDGET AND ARRANGEMENTS WITH
THE IMF CONTINUED TO BE THE SUBJECT OF WIDESPREAD
COMMENT, MOST OF WHICH WAS PREDICTABLE ACCORDING TO
THE ORIENTATION OF THE SOURCE. THE TUC ECONOMIC
COMMITTEE ISSUED A STATEMENT SAYING THE GOVERNMENT
HAD NO REAL ALTERNATIVE TO SEEKING FINANCIAL SUPPORT
ABROAD, WHICH NECESSITATED NEW SPENDING CUTS, AND RECOG-
NIZED THAT MINISTERS HAD MINIMIZED THE DEFLATIONARY
IMPACT OF THE IMF CONDITIONS, BUT REGRETTED THAT THE
NEW MEASURES WERE NOT EXPLICITLY RELATED TO AGREED
GROWTH TARGETS. THE TUC ALSO EXPRESSED SKEPTICISM THAT
EXPENDITURE REDUCTIONS WILL PROMPT HIGHER INVESTMENT IN
PRIVATE INDUSTRY, WARNED OF STRAIN ON THE SOCIAL CON-
TRACT, AND CHALLENGED EMPLOYERS TO MAKE THE SAME
"POSITIVE CONTRIBUTION" THAT TRADE UNIONISTS HAVE MADE.
CBI PRESIDENT LORD WATKINSON DESCRIBED HIS VIEW OF
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THE GOVERNMENT'S PROGRAM AS "QUALIFIED APPROVAL", SAYING
HE THINKS IT IS ABOUT AS MUCH AS COULD BE EXPECTED IN
THE CIRCUMSTANCES. THE ECONOMIST SAID THE GOOD NEWS IS
THAT THE IMF CREDIT WILL BE DOLED OUT IN INSTALLMENTS
AND THAT "RULE BY IMF INSPECTORATE GENERAL SHOULD GIVE
THE COUNTRY BETTER GOVERNMENT THAN SUCCESSIVE TEAMS OF
BRITISH POLITICIANS HAVE DONE." THE GUARDIAN RAN A

DOLEFUL EDITORIAL, SAYING THE GOVERNMENT'S CREDIT AND ITS HOPES OF KEEPING ALIVE ANY SUBSTANTIAL PART OF ITS STRATEGY SEEM DECIDEDLY WEAKER THAN AT ANY TIME SINCE THE ELECTION. THE GUARDIAN IDENTIFIED NON-PERFORMANCE UNDER THE INDUSTRIAL STRATEGY AND DANGER TO THE SOCIAL CONTRACT ALONG WITH THE VULNERABILITY OF STERLING AS CAUSES FOR CONCERN.

2. THE PRIME MINISTER VOICED "FULL SUPPORT" FOR THE CHANCELLOR IN THE COMMONS AND TOLD A MEETING OF THE PARLIAMENTARY LABOR PARTY THURSDAY EVENING TO PUT ASIDE THEIR DIFFERENCES AND SUPPORT THE ECONOMIC PACKAGE IF THEY WANT THE GOVERNMENT TO SURVIVE. PRESS REPORTS OF THE PLP MEETING SPEAK OF BITTERNESS AMONG LEFT WING MPS AT THE MEASURES INCLUDED IN THE PACKAGE. CALLAGHAN IS SAID TO HAVE REJECTED THE SIEGE ECONOMY ALTERNATIVE SUPPORTED BY THE LEFT WING AND TO HAVE ISSUED A WARNING NOT TO DESERT THE GOVERNMENT IN THE VOTE AFTER THE ECONOMIC DEBATE, WHICH IS NOW SCHEDULED FOR TUESDAY. THE TORIES HAVE SAID THEY WILL ABSTAIN.

3. THE PRESS REPORTS THAT SENIOR GOVERNMENT OFFICIALS HAVE INDICATED THAT IT MAY BE POSSIBLE TO REACH AGREEMENT ON A SAFETY NET SCHEME FOR STERLING BALANCES AT A MEETING OF CENTRAL BANK GOVERNORS IN BASLE JANUARY 10. A SENIOR WHITEHALL OFFICIAL IS QUOTED IN THE FINANCIAL TIMES AS SAYING THAT IT MIGHT BE POSSIBLE THAT SUFFICIENT PROGRESS WILL BE MADE AT A BANK FOR INTERNATIONAL SETTLEMENTS MEETING IN PARIS ON MONDAY FOR SOME LIMITED OFFICIAL USE
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INDICATION TO BE GIVEN OF THE GENERAL SHAPE OF THE PROPOSED SCHEME BY NEXT WEEK.

4. SEVERAL COMMENTATORS NOTED THE LABOR PARTY NATIONAL EXECUTIVE COMMITTEE'S CONFIRMATION OF THE APPOINTMENT OF A TROTSKYITE PARTY YOUTH ORGANIZER. WHICH THE PRIME MINISTER OPPOSED, (LONDON 20381), AS A BLOW TO THE GOVERNMENT'S POSITION, BUT FEW RELATED IT SPECIFICALLY TO THE QUESTION OF CONFIDENCE IN THE ECONOMIC PROGRAM.

5. TENTATIVE ESTIMATES, REPORTEDLY FROM OFFICIAL SOURCES, INDICATE THAT THE ECONOMIC MEASURES ANNOUNCED THIS WEEK COULD RESULT IN THE LOSS OF ABOUT 100,000 JOBS BY END OF 1978, ALTHOUGH THIS IS REGARDED AS A VERY TENTATIVE ESTIMATE. IN ADDITION, OFFICIALS HAVE INDICATED THAT ANY MARGIN TO ALLOW INCOME TAX CUTS IN THE SPRING BUDGET WITHOUT PUSHING THE PUBLIC SECTOR

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BORROWING REQUIREMENT ABOVE 8.7 BILLION POUNDS WOULD HAVE TO COME ESSENTIALLY FROM CHANGES IN THE ECONOMIC FORECAST SUCH AS A FASTER GROWTH RATE FOR EXPORTS THAN IS NOW ASSUMED, A LOW PAY LIMIT FROM ROUND THREE OF THE INCOMES POLICY, OR FROM POLICY CHANGES WHICH MAY INCLUDE FURTHER CUTS IN PUBLIC SPESBU INCREASES IN INDIRECT TAXES.

THE REFERENIHE LETTER OF AGREEMENT TO THE IMF TO POSSIBLE FURTHER MEASURES OF BETWEEN 500 MILLION OURS TO ONE BILLION FOR 1978-9 IF THE ECONOMY APPEARS TO BE GROWING FASTER ONZQNJV PERCENT A YEAR IN 1978 AND 1979 WAS SPO AND EXPLAINED AS A CONTINGENCY TO MEET PGEDLE STRAINS ON CAPACITY IN THE MANUFACTURING SECTOR RATHER THAN BECAUSE OF WORRIES ABOUT POSSIBLE FINANCIAL PRESSURES.

6. FOREIGN EXCHANGE ANRGINANCIAL MARKETS:

A. STERLING TRADING CONTINUED TO BE NERVOUS ON THURSDAY FOLLOWING THE MINI-BUDGET LOSSES OF THE PREVIOUS DAY. THE BANK OF ENGLAND KEPT THE FLUCTUATION WITHIN A SMALL MARGIN AND STERLING CLOSED AT \$1.6625,
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A 0.55 CENT FALL ON THE DAY. THE POUND FELL WITH THE DOLLAR IN LATER TRADING ON REPORTS OF AN OPEC PRICE INCREASE AND THE TRADE WEIGHTED DEPRECIATION OF STERLING SINCE THE SMITHSONIAN CURRENCY ARRANGEMENTS WIDENED 0.8 POINTS TO 45.2.

B. THE BANK OF ENGLAND LENT A MODEST AMOUNT TO ELEVEN DISCOUNT HOUSES FOR SEVEN DAYS AT THE MINIMUM LENDING RATE (MLR). THIS HAS BEEN INTERPRETED AS A SIGNAL FROM THE BANK THAT A 1/4 PERCENT FALL IN THE MLR AT TODAY'S TREASURY BILL AUCTION IS ACCEPTABLE BUT NOTHING GREATER. THE MARKETS BELIEVE THAT THE AUTHORITIES CANNOT CARRY OUT A LARGER CUT IN THE MLR WITH THE CURRENT WEAKNESS IN STERLING.

C. THE GILT MARKET REACTED SHARPLY ON THURSDAY TO THE CHANCELLOR'S MINI-BUDGET AND THE PROSPECTS OF A LESS THAN HOPED FOR CUT IN THE MLR, IN A WAVE OF NOON SELLING. SHORT DATED GILTS CLOSED WITH LOSSES GREATER THAN 1/2 POINT WHILE LONG DATED GILTS SHOWED LOSSES GREATER THAN A FULL POINT. IN EARLY FRIDAY TRADING, PART OF THESE LOSSES WERE RECOVERED AS CONFIRMATION OF OPEC DISUNITY OVER OIL PRICES WAS RECEIVED.

D. THE EQUITY MARKET RALLIED ON THURSDAY FROM ITS LATE WEDNESDAY LOSSES, AS THE FINANCIAL TIMES INDEX OF ORDINARY INDUSTRIALS INCREASED FROM 313.8 TO 322.7.

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